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SENSITIVE

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SUBJECT: NEW FINANCE MINISTER TALKS FISCAL DISCIPLINE

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Summary

1. (SBU) The Ambassador met new Finance Minister Ivan Suker February 10. Suker declared the government's intention to negotiate a new Standby Arrangement with the IMF -- apparently EU pressure caused the government to overcome earlier misgivings about another SBA. Such an agreement would mean crafting a restrictive budget. Suker emphasized fiscal discipline first, tax cuts second. The Ambassador reviewed various USG assistance projects and asked for more feedback to make them more effective. Suker, a former mayor, emphasized the importance of strong financing mechanisms at the local level. End Summary.

"Dedicated to new Standby Arrangement"

2. (SBU) Suker began the February 10 meeting with the Ambassador by noting that he was embroiled in tough negotiations with various ministries in an attempt to put a budget together (the government has until the end of March to put together its first budget -- it is currently operating on a provisional budget passed by the last government). He believed that this first budget would demonstrate to the international community and to the financial markets the HDZ government's seriousness.

3. (SBU) Suker highlighted the government's intention to pursue a Standby Arrangement with a target budget deficit of 4.5-4.8 percent of GDP (this would be far above the 3.8 percent the last government agreed with the IMF for this year). He argued that the last government had "achieved" a budget deficit of 4.8 percent -- far below the target of 6.7 percent -- in 2002 only by failing to fulfill commitments. While the figures are not yet official (or even public), the previous government had NOT met its 4.5 percent target for 2003; he believed the figure was 5.8 percent. Thus, 4.5-4.8 percent this year would represent real discipline. "We will need to say 'no' to a lot of spending." The Ambassador noted that he had just met with the Minister of Transportation, who had a lot of ambitious -- and expensive -- projects. Preparing for NATO would also not be a cheap endeavor.

Tax Cuts to Wait

4. (SBU) Suker also said that tax reform could come only after deficit reduction. Suker did not even mention one of the HDZ's most important campaign promises -- VAT reduction -- but rather stressed the importance of lowering the cost of labor (i.e., payroll taxes) to stimulate employment.

5. (SBU) Suker highlighted the need to bring order to government finances -- he would begin by sorting out the Treasury function in the Ministry. Transparency would also be a focus.

Leadership Needed to Make Assistance Work

6. (SBU) The Ambassador explained that, in the last government, the Mission had found the Ministry often unresponsive. Given the appointment of so many evidently competent people to the Ministry, we looked forward to a better relationship, particularly in implementing our assistance programs. Many of our programs were designed to achieve just what the Minister had identified as his principle goal -- getting a grip on finances. Much of our assistance to the Ministry was coming to an end in September. To maximize its effectiveness, we wished to work closely with Ministry, especially in the areas of continuing to implement a new financial information management system and the area of fiscal decentralization.

7. (SBU) Suker noted that as a mayor until the end of last year, he had seen how localities should not and could not rely on the central government. He remarked on the need to simplify and streamline the patchwork of taxes and fees and

to improve the management of infrastructure -- areas where
U.S. assistance can help.

Comment

18. (SBU) Suker -- an ex-mayor and tax collector -- sounded
the right notes on the need for fiscal discipline. He may

find the IMF a good stick with which to beat his fellow
ministers, as he tries to ratchet down the deficit. However,
the IMF will likely demand, at least as a starting position,
more ambitious deficit reduction than that contemplated by
the government --- we understand in the neighborhood of 4.0
percent. Meanwhile, the pensioners are getting restless, the
Ministry of Defense needs to invest in NATO preparedness, and
the ambitious Minister of Transportation has plans for roads,
bridges, railroads and a new Coast Guard. It is unclear to
us that Suker has the political weight to push back against
more politically influential ministers. Only the interest of
the EU in Croatia continuing with an SBA has brought the
government this far; at some point the government will have
to balance constituencies against IMF and EU pressure.
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